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## FRONTIERS OF REGULATION AND WHAT LIES BEYOND

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For decades we have been working to break up the so-called trusts and restore competition in their place, but we seem to have accomplished little more than to reveal obstacles, obstacles that to many seem insuperable. Our dissolutions dissolve nothing: combinations are Protean, and we are baffled by shadowy communities of interest which seem to have no bodies we can grasp. Our lawyers perform inscrutable incantations, making many stock certificates grow where one grew before, but the people are not satisfied that these ceremonies have exorcised the spirit of monopoly from the body of large business. As a result, many are calling on us to cease the effort, to let business be monopolistic if it will, but to rob it of its power for harm by regulating the qualities and prices of goods and services wherever competition ceases to do this for us. Shall we follow this counsel?

The problems of regulating modern large-scale businesses are being worked out by our railroad and public utility commissions, in ways that are familiar to this audience. At one of the sessions of this society three years ago we were reminded that the most complicated and obstinate prices of all are already being dealt with by the Interstate Commerce Commission. After the bewilderments of railroad rates, any price problem of a mere manufactured commodity cannot but seem simple by comparison. It becomes the most natural thing in the world, then, to say "Let us make a commission to do for the trusts what the Interstate Commerce Commission does so successfully for the railroads," or "Let us follow the model of our best public utility commissions, and the path will be a plain one."

It is a dangerous thing for anyone posing as a scientist to make predictions that are likely to be proved, or disproved, in the near future. And in raising my voice against the rising tide of price regulation, I shall try to bear with fortitude the risk I run of sharing the legendary experience of King Canute. The only way of safety lies in treating the future from the vantage ground of past and present, asking first "What has been done already?"

and then, "How is the new task different from the old, and where will our stock of experience fail us?"

The thesis of this paper is that the fixing of levels of business prices and earnings is a subject about which this country does not yet know as much as many optimists suppose, that trust control by this method would raise new and serious difficulties of a kind not yet experienced, and that far from being the simplest way of handling trusts, this method, if carried out to the end, might unsettle our economic foundations in a way that would make our present perplexities seem trivial by comparison.

The choice we must make is not between regulation and destruction, as some seem to think, nor between regulation and *laissez faire*. The choice is between two kinds of regulation, one of which would admit monopoly and aim to prevent extortion, while the other policy, no less constructive than the first, would bend every energy to reviving and regenerating competition. This second policy will be found safer, and in the long run easier, than a program of price fixing.

## I

In the first place, we have not completely settled the most fundamental problems even in the field of recognized public utilities, to say nothing of the new ones that trust regulation would raise. The Interstate Commerce Commission has not yet completely solved, has not had the opportunity and the machinery to solve, the problem of regulating the general level of railway charges. The greater part of their splendid work has been wrestling with single rates and discriminations, while the trust problem, if competition cannot be restored, is essentially that of the general level of prices and profits.

It is true that the Commission has handed down one decision involving the level of charges for half the freight tonnage and revenue of the country<sup>1</sup> and covering a region which extends from Chicago and the Mississippi River on the west to the Hudson River and Atlantic seaboard on the east, and from the Great Lakes and the St. Lawrence River on the north to the Ohio River and Norfolk on the south. Here, surely, is an instance of effective regulation of the general level of charges and profits. But as to whether this furnishes a satisfactory model for a permanent policy

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<sup>1</sup>"In Re Investigation of Advances in Rates by Carriers in Official Classification Territory," XX I. C. C. Rep. 243.

of trust regulation, let the Commission speak for themselves. Their reply to the carrier's plea of necessity begins with these remarkable words: "Strictly speaking the Commission has no jurisdiction to hear and determine that question. We have no authority, as such, to say what amount the carriers shall earn, nor to establish a schedule of rates which will permit them to earn that amount."<sup>2</sup> And again, "We have no authority to say that a railroad ought to earn, either as a matter of right, or as a matter of public policy, any given percentage upon its value, but in discharging our duty, to say whether these particular rates . . . are just and reasonable, we must determine in a general way what a fair return would be . . ."<sup>3</sup> Again: "We have been compelled to dispose of this case upon the evidence available . . . there is no testimony tending to show the cost of reproducing these properties. It is plain that a physical valuation would introduce into the calculation a new element which might lead to a different conclusion. The conclusion reached here extends, therefore, no farther than the facts upon which it is based."<sup>4</sup>

This is hardly the language of a body which has its own peculiar difficulties so well in hand that it can serve as a finished model for the regulation of trusts by the same methods. The effectiveness of the findings is made possible solely by the fact that the law laid on the railroads the burden of proof that the increased rates were reasonable. But the law does this, not in all cases, but merely when an increase of rates is in question, so that this legal weapon could not be used to force down rates that are already too high. This of itself is not necessarily a fatal weakness, for if Professor Fisher is right in predicting a generation of rising prices, then any unreasonable price, if forcibly kept at its present level, might ultimately become reasonable in comparison to the rest. However, the people are not likely to wait so long as that, and any policy of general price regulation must provide for lowering prices when they are too high by some method more effective than our federal railroad law now contains. If a physical valuation is demanded by the Interstate Commerce Commission as a necessary condition of effective work, how much more necessary will it be to a future Interstate Industrial Commission charged with price-making powers! And the physical valuation of all the large-scale

<sup>2</sup> "In re . . . Advances in rates . . ." *Op. cit.*, p. 243.

<sup>3</sup> *Op. cit.*, p. 262.

<sup>4</sup> *Op. cit.*, p. 305.

industrial capital of the nation is a task of whose vast magnitude we can have but little idea.

But there are other questions which are not by any means settled. In the first place, how allow for the fact that the prices that give reasonable earnings to some producers might bring ruin to others less efficient? To use again the words of the Interstate Commerce Commission: "There is no way by which such a condition can be remedied unless the government makes a direct appropriation for the support of roads in this condition."<sup>5</sup> This question is one on which we have not yet heard the final word.

Another and still more vital issue is how to stimulate that progress in efficiency without which our multiplying millions dare not face the future. Fear of loss and hope of profits are the spurs to most improvements, and if we are to have a rate of dividend fixed by law we must furnish some substitute incentive for the one we have removed. With regard to this the Commission says: "Before any general advance in rates can be permitted it must appear with reasonable certainty that carriers have exercised proper economy in the purchase of their supplies, in the payment of their wages, and in the general conduct of their business."<sup>6</sup> So far, so good. But farther than this the Commission will not go, for they say again: "This Commission is not a general manager of the railroads, and no matter what the revenue the carriers may receive there can be no control placed by the Commission upon its expenditure, no improvements directed, and no economies enforced."<sup>7</sup> And in response to the claim of learned counsel that by "scientific management" the roads could save \$300,000,000 a year, the answer was that these methods were in an experimental stage only, and that they could not be allowed for in deciding the case at issue. Economy we may demand, but no innovations.

In some respects the best of our public utility boards are in a stronger position than the Interstate Commerce Commission. They have physical valuations, they can order and direct improvements, and they are in a position, if they choose, to furnish motive to further progress and economy by using the principle of the sliding scale, which has worked so well with the Consolidated Gas Company of Boston, and is so widely used in England. But these methods could not be carried over into trust regulation without

"In re . . . Advances in Rates . ." (western case) XX I. C. C. Rep. 378.

<sup>5</sup> *Op. cit.*, p. 243.

<sup>7</sup> *Op. cit.*, p. 307.

losing most of their virtue. If the power plant of a particular city is backward, it can be ordered to copy the standards and practices of more efficient companies. But no industry can progress indefinitely by this method. The best plants, too, must go on improving. We must not merely "bring our line up to the colors" and stop there. Line, colors, and all must go on advancing. Costly experiments must be tried and innovations tested at some risk, if we are to escape from industrial backsliding, and these results cannot be secured by executive mandate or legislative fiat.

The sliding scale, on the other hand, furnishes a motive to continued progress, but it is useless for trust control, for it can be applied only to complete consolidations whose methods of production are very nearly static. The principle of this scheme is that the gain resulting from improvements should be shared between the consumer, who gets lower prices, and the company, which is allowed higher dividends, in some mathematical proportion, starting from certain levels which are taken as standards both of prices and of dividends. Thus economies bring increased gains to management and public alike.

Why does this not solve the whole problem? Chiefly because there is only a very limited field in which it will work properly. The whole success of it depends on leaving it undisturbed for a considerable term of years without tampering with the standard rates on which the calculations are based. This means that businesses that are progressing rapidly cannot use it, for they may be revolutionized at short notice by inventions which would turn existing scales of prices into absurd anachronisms and would cause an irresistible demand for revision. It would be absurd to allow a corporation to earn 20 or 30 per cent dividend for six or eight years merely as a reward for copying some revolutionary invention for which a competitor, or a foreigner even, might have been originally responsible. In the past century, industrial change and progress have come so fast that no sliding-scale system could have kept up, and we hope to see no slackening of our pace. Even in the relatively static field of public utilities, sliding scales may prove too rigid in some cases. The expert who recently reported on sliding scales to the Railroad (and public utility) Commission of Wisconsin<sup>8</sup> concluded that conditions there were too dynamic to warrant following the example of Boston and the British municipalities in this respect.

<sup>8</sup> H. J. Thorkelson: Report on "Sliding Scale" Sept., 1911.

Another obvious limitation of the sliding-scale method is that it applies only to an absolute monopoly. For a pool every member of which earned a different rate of dividend, or for a typical trust including many plants, and with substantial competitors still surviving, this scheme would be absolutely unsuited, and some other way of stimulating progress must obviously be found. If the old competitive stimulus is to go, another must be provided, but how to do this is a question that no system of price regulation yet seen has fully answered.

## II

So much for the unsettled problems in the business we are already regulating. In controlling trusts by the same method we should meet the same difficulties in intensified form. In only one important respect will the regulator of trusts have a decided advantage over the regulator of railways and public utilities. The question of preventing undue discrimination will take a far simpler form. On the other hand, as has just been shown, the stimulating of efficiency will be a harder task than ever. The task that will be likely to furnish the greatest immediate difficulty, however, is that regulation of qualities which must go hand in hand with regulation of prices, if the latter policy is not to be completely stultified.

In this respect the public service industries are much easier to handle than many lines of manufacture in which quality is so largely a matter of taste that scientific tests are of little use. It is easy to measure the voltage supplied to electric lights, or the illuminating power of gas, in definite figures, and even the promptness and safety of railway carriage can be tested by statistics, but what sort of yardstick shall we take to measure the fragrance, flavor, and drawing qualities of a trust-made cigar? Most industrial processes turn out a certain percentage of "seconds," or slightly inferior goods, which may or may not be sold with the firsts, and a company may evade a price regulation merely by increasing the percentage of seconds that is allowed to go out. We shall have a truly difficult task if we undertake to govern this practice in all its ramifications.

But aside from the old, familiar difficulties, the taking over of even a few trusts would raise some further troubles of a wholly novel sort. We have had some experience in limiting the earnings of industrial and commercial capital, but what shall we do

with those of agricultural land, and with royalties on mines and patents, when these come up for determination? Returns to land have been already controlled, in an incidental way, but never independently. The land has been valued on a basis of its other uses, a method which works well enough for the small areas needed in these cases but would be useless if applied to great areas of farm lands.

“But what has the control of trusts to do with agriculture?” may be asked. It has everything to do with it. Less than five years ago Kentucky swarmed with armed night riders, till life was not safe. And the cause? Resistance to the Tobacco Trust and the low prices it paid the tobacco growers, this resistance taking the shape of an attempt to organize a counter-monopoly. If we cannot allow night-riding, neither can we allow the oppression that causes it. We cannot fix prices of things trusts sell without fixing also the prices of things they buy, wherever they become monopolistic in their buying. We cannot let the trust evade regulation by merely shifting the burden one step back on to the producer of raw materials; we must fix these prices also.

The far-reaching effects of such a policy can hardly be exaggerated, nor its perplexities overestimated. The size of the crops is the most uncertain thing in our whole business life, and the yield of animal products only less so; and for that reason any price system that should be at all rigid would do the utmost damage. As it is, the high price in a year of shortage makes some amends to the farmer for his scanty yield, and *vice versa*. But if the price were kept steady, then in a year of plentiful yield the demand would fall short of the supply, and many farmers would be left with their crop on their hands, so that the last state of those men would be worse than the first. The trouble could only be avoided by a subsidy, or by forming a farmer's cartel so huge that none should be left out, and this would prove no easy task.

The regulation of forestry and mining would avoid this particular difficulty of extreme seasonal uncertainties, but would present many conflicting motives of its own. We are already torn between our desire to curb the earnings of suspected monopolies on the one hand, and the knowledge that low prices lead to wasteful methods of extraction on the other. The conservationist and the consumer have already come in conflict, and it is impossible to set up any very definite rule by which a regulating commission should settle the issue. One good thing the anthracite combination has



accomplished is to cut down the proportion of wasted coal from three tons in every five to a probable one ton in every three, both by saving the small sizes and by reducing the amount that is left underground beyond recovery.<sup>9</sup> The high prices of coal have undoubtedly contributed to make these savings financially profitable to the companies, and thus the consumer of today is being taxed for the benefit of posterity. It may be possible even to convince the consumer that he ought to make this public sacrifice, but it will be hard to convince him that the resulting public benefit is rightly the private perquisite of the owners of the coal mines. There is strong ground for believing that the conflict here revealed is irrepressible, and cannot be settled satisfactorily short of public ownership, and that it is to this result that regulation of mining profits would lead us.

Another hard nut to crack would be the treatment of patented processes wherever such patents make a substantial part of the monopoly power of the trust. These legal monopolies cannot be handled quite as boldly as the franchise privileges of public utility companies are, and greater liberality must be practised toward the holders. While a public utility franchise is a legal monopoly, it is properly granted with the reservation that charges must be reasonable. A patent, on the other hand, is subject to no such restriction. When we regulate the charges of a utility we are not encroaching on the franchise, for the right to regulate was implied in the terms of the franchise itself; but when we start to restrict the prices of manufacturers who enjoy patent rights we are in danger of striking legal snags. And there are few important industrial concerns without some patented processes among their assets. We cannot confiscate patents arbitrarily, and yet if patented processes make possible an industrial monopoly of the goods that are turned out, can government regulate the prices charged by that monopoly without diminishing the value of the patent privilege which itself has granted?

The solution of this question is a task for lawyers, not economists, but there is one point that can be grasped, even by the economic intellect. If we undertake to regulate prices we shall probably regulate them in the end, patents or no patents, but we shall have to make a change in the standing of patent rights quite as radical as any of the proposals that have been recently introduced in Congress to compel patentees, in certain circumstances, to grant

<sup>9</sup> Brief for U. S. in *U. S. v. Reading Co. et al.*, pp. 124-131.

licenses for a "reasonable" royalty fee. If these current schemes for restoring competition are objected to because they involve tampering with patent rights, the scheme for price regulation is a pot of the same color, blackened at the same fire.

For all these reasons, then, we shall find our experience with public utilities will not fit the new requirements without many distinct alterations and some considerable additions. And if we were to adopt this policy because it seemed simple, we should be rudely disillusioned.

### III

But the chief dilemma of all is still to come. So far it has been assumed that only a few trusts were made subject to price regulation. But if price regulation should become general and cover the whole field of trust industry, the very standards that now guide regulators would be taken away, for our conceptions of "reasonable" earnings are drawn from parallel industries that remain competitive. If we admit that the tendency to monopoly is the law of large-scale business and do not combat that tendency, we must lay our plans in the expectation that it will go on, and work out its logical results.

How much business will be left competitive and free of price regulation? We should have retailing, jobbing and repairing, some small-scale manufacturing, and especially businesses like printing and publishing and the making of novelties and specialties, in which the capital invested is relatively small and the personal equation relatively important. In agriculture we should have left only the raising of crops which are not sold to monopolies, such as truck and fruit-farming, the raising of hay, of draught animals, and in general of any produce which is in shape to be sold direct to the retailer. Even here farmers' coöperative selling bureaus may conceivably become so unified and powerful as to call for regulation. Such staples as wheat and corn may or may not keep their competitive outlets. Dairying is also a doubtful quantity, while the field of price regulation will be practically sure to absorb the raising of sugar, cotton, tobacco, and live stock for meat, hides, and wool.

If we fail, then, in the task of restoring competition and if the movement toward regulated monopoly goes on, we shall be confronted by a rather startling condition. The competitive field will have been narrowed to a minority of business, and that minor-

ity not even a representative one, for it will contain no businesses whose problems and risks are those of large fixed plants, nor any which use steam, electricity, and machinery on a vast scale. At present, in regulating monopolies we have the advantage of a huge competitive field from which to borrow our standards of efficiency, risk, and especially our standard of a reasonable rate of earnings. What shall we do when these standards are no more, when instead of a field of monopoly subsidiary to a system of general competition the case shall be reversed, and we have but a few fringes of competition entirely subordinate to a system based on regulated monopoly?

The mere size of the task of control might well appal us. Some hold that we can escape this difficulty, for they urge that, just as the Interstate Commerce Commission has been called on to fix but a small minority of the railroad rates of the country, so an Interstate Industrial Commission might find its task could be kept within small compass and so made relatively easy; that it need merely stand ready to fix prices on complaint; and that it could keep them in order by holding over the companies the threat of price fixing without being forced to any very general and active use of this big stick. But the evidence is much against such an optimistic forecast. The biggest example of this sort of regulation at present is the Interstate Commerce Commission. This body heard, in 1911, 881 formal complaints and over 4000 informal ones, or more than one formal complaint and five informal for every independent operating road in the country. If the average of dissatisfied customers ran as high for industrial trusts, it would not take many years at this rate to call in question substantially all the prices on their books. Moreover, even in railroad regulation the time is rapidly passing when control is a matter chiefly of single rates, and we are entering on more and more comprehensive hearings of whole schedules of charges, until in the cases already cited the Commission regulated at one blow the rates on which moved half the freight tonnage of the country. We cannot expect to evade the issue of price fixing, but must face it, even though it forces us to set a value and a rate of earnings on all the land, mines, and industrial capital of the nation.

But the most startling thing about this situation is that while laying on us the duty of regulating the prices and profits of most of our big business it would at the same time have taken away the very yardstick we now use to determine reasonable rates and

earnings in the regulating we now do. What is a reasonable rate of earnings? The most definite and immediate measure is furnished by the rate earned in competitive businesses that are more or less similar in general characteristics, and especially those that involve about equal risk. But when all businesses of a markedly capitalistic type shall be regulated, our very base line of regulation will thus have disappeared, and we must make our own standard of reasonable earnings. We must control the general level of business earnings, from which hangs the rate of interest itself.

The ultimate force which must limit all attempts at regulation is the necessity of attracting capital enough to develop our business opportunities to the full. The prevailing shortage of cars on our railroads is pointed to as evidence that we are reaching this limit in our regulation of freight rates, though the force of this argument is somewhat diminished by the fact that there also appears to be an undersupply of ocean going freight steamers at the same time. However this may be, one thing is sure, that if too strict a policy is followed in this country we must expect American capitalists to seek more and more foreign investments, while American business suffers the results of the exodus.

One method of judging might be through the market price of stocks and bonds. If these could be sold in the open market above par, assuming them unwatered, this might be taken as a guarantee that earnings had not been reduced beyond the limit set by a wise public policy. However, to study all the theoretical possibilities of the case would lead us too far afield. It is not the purpose of this paper to prove that general control of prices is possible or impossible, merely to point out how appallingly far-reaching, how deeply unsettling, such a policy would be, and this has been sufficiently indicated.

#### IV

All these difficulties will weigh not a feather with those who believe that large-scale competition is doomed, and who are writing premature obituaries while the patient is still on the operating table. But this patient has a strong constitution, and there are many remedies that have not yet been given full trial. If we reform patents, enforce a one-price system, prevent exclusive contracts and all other unfair and predatory practices, and encourage scientific cost accounting, we shall have made a good

beginning toward a cure; toward reëstablishing sane and normal business rivalry.

Even under the plan of controlling prices some of these things must be done. The standing of patent rights must be revolutionized, and discriminations prevented. But the program of price fixing goes beyond these simpler remedies to other tasks that far overshadow them. The hardest task in restoring competition is to make dissolutions genuine. But the difficulties of price fixing are legion.

If we can succeed in restoring competition, the greatest need of all will be met, for industrial progress will take care of itself, without need of being bolstered up by sliding scales or other difficult administrative machinery. Rents and royalties and the general rate of property income can be left to the free play of supply and demand, to the vast relief of those on whom might fall the task of controlling these shares of the nation's income.

If the policy of restoring competition fails, and we must admit the possibility that it might fail in some cases, we have still the more direct method of control to fall back on. But if we place our reliance on regulation of prices at once, and permit combinations, and then find ourselves disappointed in the results, it may prove to be too late to return to a competitive condition. The alternative then before us will be public ownership, and a long stride in the direction of state socialism. Is it not the wiser and in the long run the easier course to keep the regulation of prices as a last resort, with a firm determination that the occasions of its use shall be few and far between?